



November 2016

Report No. 16-06

## Over the Long-term, Major SBA Fund Returns Exceeded Market-Based Investment Benchmarks; FRS Pension Fund Multi-Year Performance Similar to Other States

### *at a glance*

Over the long-term, State Board of Administration investment returns for all five major mandate funds met or exceeded market-based investment benchmarks.

While its one-year return for Fiscal Year 2015-16 was less than 1%, the Florida Retirement System (FRS) Pension Plan fund generally exceeded market-based investment benchmarks over the long term. Similarly, while the fund's one-year return for Fiscal Year 2014-15 was less than returns for some other states with large pension funds, its multi-year performance was comparable.

The Florida PRIME Fund also exceeded market-based investment benchmarks. One-year returns for the FRS Investment Plan, the Florida Hurricane Catastrophe Fund, and the Lawton Chiles Endowment Fund fell short of benchmarks in Fiscal Year 2015-16, but met or exceeded 3-year, 5-year, and 10-year benchmarks.

### Scope

Section 215.44(6), *Florida Statutes*, requires OPPAGA to perform a biennial evaluation of the State Board of Administration's (SBA) management of investments. This review examines the SBA's Fiscal Year 2014-15 and Fiscal Year 2015-16 performance to determine, in general, how well the board's major mandate funds are performing.

<sup>1</sup> The SBA also invests funds on behalf of direct-support organizations of the state and political subdivisions.

<sup>2</sup> The SBA defines mandate investment funds as those for which board responsibilities are required by state law. The SBA refers to the largest of these as major mandates. Other mandate funds include the Florida Lottery and the Florida Prepaid College Plan.

### Background

The State Board of Administration is primarily an asset management organization that invests funds contributed on behalf of state agencies, school boards, educational institutions, and units of local government.<sup>1</sup> The board is composed of the Governor, Chief Financial Officer, and Attorney General, who serve as trustees to the funds under board management. The trustees appoint the SBA's executive director, who oversees the general management of investments.

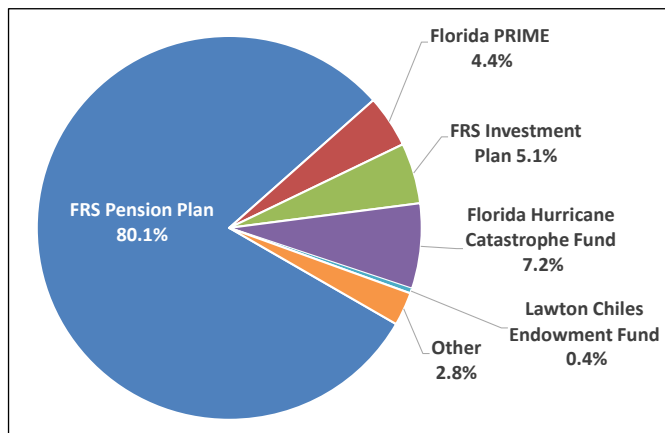
As of June 30, 2016, the board managed 35 funds with a total market value of \$176.4 billion. The SBA's major mandate funds are the

- Florida Retirement System (FRS) Pension Plan;
- Florida Hurricane Catastrophe Fund;
- FRS Investment Plan;
- Florida PRIME Fund; and
- Lawton Chiles Endowment Fund.<sup>2</sup>

The largest fund is the FRS Pension Plan, which had net assets of \$141.3 billion and comprised 80.1% of the total assets managed by the board in Fiscal Year 2015-16.<sup>3</sup> (See Exhibit 1.)

<sup>3</sup> The net market value of FRS Pension Plan assets decreased from \$148 billion on June 30, 2015, to \$141.3 billion on June 30, 2016. The SBA largely attributes this decrease to low investment returns and larger than normal withdrawals including \$1.9 billion in payments to retirees leaving the Deferred Retirement Option Program.

**Exhibit 1**  
**Total Market Value of SBA Investments Was \$176.4 Billion as of June 30, 2016<sup>1</sup>**



<sup>1</sup> Total market value refers to the net value of SBA assets as of June 30, 2016. Source: OPPAGA analysis of State Board of Administration data.

Unlike most state agencies, the SBA does not receive a legislative appropriation to support its activities. Instead, the board funds its operational and administrative expenses through fees derived from its investment management services of the funds entrusted to it for investment purposes. To manage its investment activities in Fiscal Year 2015-16, the board had an operating budget of \$42 million and 198.75 authorized positions.<sup>4</sup>

## Findings

The State Board of Administration uses several methods to evaluate fund performance. These methods include examining investment returns relative to market-based benchmarks, comparing the investment returns to those of other large investors, and comparing these returns to the board’s overall investment objective for each fund.

<sup>4</sup> The board also had 51 positions and budgeted \$130.4 million for the Florida Hurricane Catastrophe Fund, the Division of Bond Finance-Arbitrage Compliance, the Division of Bond Finance-Revenue Bond Fee, the College Savings Program, the Prepaid College Board, and the FRS Investment Plan/Office of Defined Contribution. This includes up to \$67.8 million for acquiring reinsurance for the Florida Hurricane Catastrophe Fund.

OPPAGA reviewed the SBA’s performance investing fund assets and found that, in general,

- several major mandate fund returns fell below market-based benchmarks for a one-year period but equaled or exceeded benchmarks in longer time periods;
- FRS Pension Plan returns have generally exceeded the SBA’s overall investment objective for most of a 25-year period; and
- FRS Pension Plan investment returns were similar to those of other state pension funds of a comparable size over multi-year terms.

***Over the long-term, major mandate funds exceeded market-based investment benchmarks***

SBA investment returns help fund a range of state and local government programs, including pension benefits. To measure investment performance, the board establishes benchmarks for each of the five major mandate funds based on market indices.<sup>5</sup>

The SBA fund benchmarks vary widely based on the state’s goals for the individual funds. For example, local government units like counties and community colleges are eligible to use Florida PRIME to hold surplus funds. This fund emphasizes preservation of capital, liquidity, and competitive yield. Generally, these investments have lower returns and lower associated benchmarks. Conversely, the SBA’s goal for investing FRS Pension Plan assets is to provide investment returns sufficient to ensure timely payment of promised benefits to current and future plan participants as well as to keep costs at a reasonable level. To obtain sufficient returns, the SBA invests FRS Pension Plan assets primarily in investment vehicles, such as stocks, that potentially yield higher long-term returns than bonds and cash. As such, these investments generally have higher benchmarks.

<sup>5</sup> A market index tracks and measures changes in the performance of a specific group of stocks, bonds, or other investments from a specific starting date. As an example, the performance of domestic equities within the Pension Plan fund is measured against the Russell 3000 Index, which is an index measuring the performance of approximately 3,000 of the largest companies in U.S. stock markets.

SBA investment returns for the five major mandate funds compared to the funds’ benchmarks varied depending on the review period. For one-year returns, three of the five major mandate funds had returns below their benchmarks, while the FRS

Pension Plan and the Florida PRIME Fund exceeded theirs. Investment returns for all major mandate funds met or exceeded 3-year, 5-year, and 10-year benchmarks. (See Exhibit 2.)

**Exhibit 2**

**As of June 30, 2016, SBA Major Mandate Fund Returns Generally Exceeded Market-Based Investment Benchmarks for Periods up to 10 Years**

Major Mandate	1-Year Trailing Return <sup>1</sup>	3-Year Trailing Return	5-Year Trailing Return	10-Year Trailing Return
<b>FRS Pension Plan</b>	0.5%	7.0%	6.8%	5.9%
Performance Benchmark	-0.1%	6.1%	5.9%	5.3%
<b>Hurricane Catastrophe Fund</b>				
<i>CAT Operating Fund</i>	0.4%	0.3%	0.3%	1.2%
Performance Benchmark	0.6%	0.3%	0.2%	1.2%
<i>CAT 2013A Fund</i>	0.5%	0.3%	N/A	N/A
Performance Benchmark	0.6%	0.3%	N/A	N/A
<b>FRS Investment Plan</b>	-0.9%	5.5%	5.5%	4.9%
Performance Benchmark	-0.4%	5.4%	5.4%	4.5%
<b>Florida PRIME Fund</b>	0.4%	0.2%	0.3%	1.3%
Performance Benchmark	0.2%	0.1%	0.1%	1.1%
<b>Lawton Chiles Endowment</b>	-1.5%	6.2%	5.9%	5.0%
Performance Benchmark	-1.3%	5.5%	5.1%	4.4%

<sup>1</sup> A trailing return shows how a fund has performed over the period shown. For example, a 1-year trailing return as of June 30, 2016, would show a fund’s performance from July 1, 2015, to June 30, 2016. A 10-year trailing return as of June 30, 2016, would show a fund’s performance from July 1, 2005, to June 30, 2016.

Source: State Board of Administration.

***For the FRS Pension Plan Fund, SBA generally exceeded its overall investment objective over time***

The SBA also measures its investment performance for the FRS Pension Plan relative to an overall investment objective. Specifically, SBA’s objective is to achieve compounded investment earnings of 5% over the annual rate of inflation.<sup>6,7</sup> Consequently, the objective varies yearly as inflation changes. This objective shows how the fund is performing over multiple market cycles (e.g., over 25 years).

For Fiscal Year 2015-16, the SBA did not meet its overall FRS Pension Plan investment objective over the one-year term. (See Exhibit 3.) The board attributed this performance to devaluations in

Chinese currency and the U.S. Federal Reserve raising interest rates 25 basis points. The SBA also attributed this performance to central banks in Europe and Japan increasing stimulus measures to jumpstart their economies and the vote in Great Britain to separate from the European Union.

However, the SBA met or exceeded its overall investment earnings objectives for the FRS Pension Plan Fund for four of the remaining six periods—3, 5, 20, and 25 years. The SBA reported that the lower returns for the 10-year and 15-year period likely continue to reflect two extreme market events that occurred between Fiscal Years 1999-00 and 2013-14—the “technology bubble” bursting and the global financial crisis.

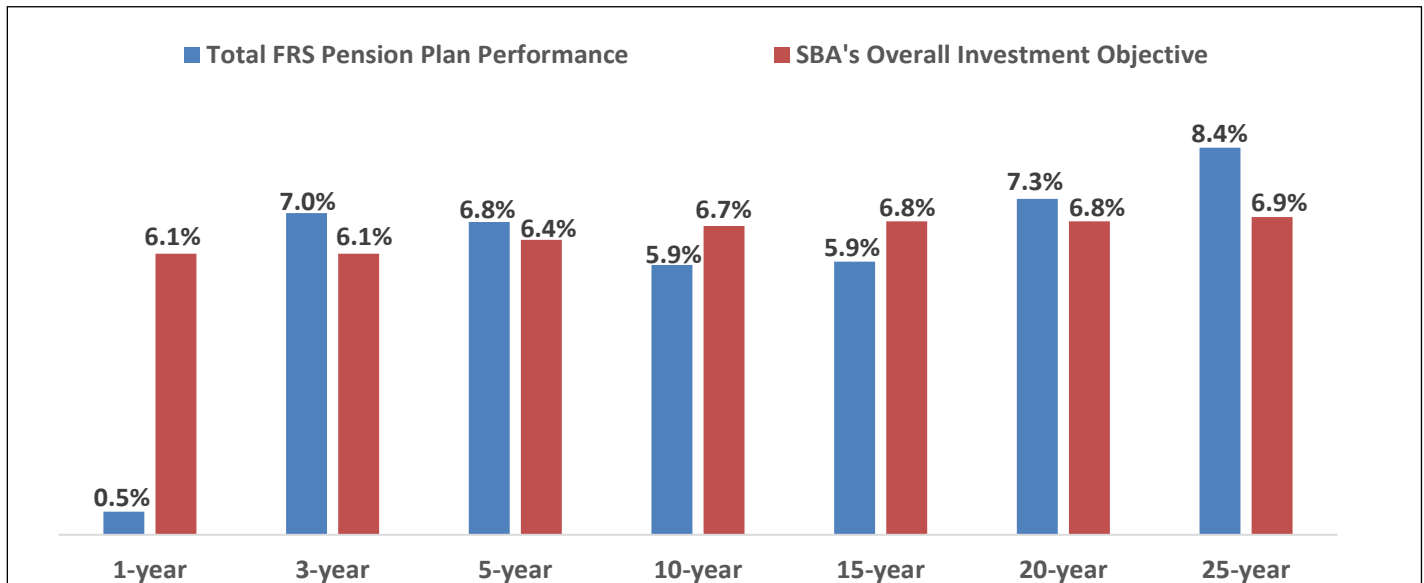
<sup>6</sup> The SBA Board of Trustees sets this overall investment objective and the level of investment risk. The SBA reported that this objective closely tracks the investment return assumed by the FRS actuary. It is based on an analysis of expected benefit growth, contribution levels, market performance, and risk tolerance for the fund. The SBA uses the compounded U.S. Department of Labor Consumer Price

Index (all Urban Consumers) to represent the inflation rate.

<sup>7</sup> The FRS Pension Plan Fund overall investment objective has changed over time. The investment objective went from 4.30% over the rate of inflation (in effect since January 1, 1976) to 4.00% over the rate of inflation on June 1, 2003. The current investment objective (5.00% over the rate of inflation) took effect on June 1, 2007.

**Exhibit 3**

**As of June 30, 2016, Pension Plan Investment Returns Did Not Meet 1-Year Objective, but Generally Exceeded SBA's Overall Investment Objective in the Long-Term<sup>1</sup>**



<sup>1</sup> Annualized returns are net of fees.

Source: OPPAGA analysis of State Board of Administration data as of June 30, 2016.

***FRS Pension Plan's multi-year performance was similar to that of several large public pension funds***

The SBA's one-year investment performance for FRS Pension Plan funds in Fiscal Year 2014-15 was 3.7%. This one-year return was lower than five other pension plans OPPAGA examined and higher than the one-year returns for two other pension plans.

However, FRS Pension Plan investment performance over multi-year periods was comparable to that of other large public pension funds. For example, the SBA's 10-year return on the FRS Pension Plan fund was 6.9%, and the seven comparison funds had 10-year returns that ranged from 6.2% to 7.3%. (See Exhibit 4.)

**Exhibit 4**

**Despite Its One-Year Performance in Fiscal Year 2014-15, the FRS Pension Plan's Multi-Year Investment Returns Were Similar to Those of Other Large Public Retirement Plans<sup>1</sup>**

Fund	Overall Rate of Return				Net Market Value of Pension Assets (in Billions)
	1-Year	3-Year	5-Year	10-Year	
New York State and Local Retirement System	7.2%	10.2%	10.2%	7.1%	\$184.5
Teacher Retirement System of Texas	6.4%	7.2%	9.8%	7.1%	\$127.9
State Teachers Retirement System of Ohio	5.5%	11.9%	11.9%	7.3%	\$76.2
New York State Teachers' Retirement System	5.2%	12.2%	12.4%	7.2%	\$106.7
California State Teachers' Retirement System	4.8%	12.3%	12.1%	7.0%	\$191.4
<b>FRS Pension Plan<sup>2</sup></b>	<b>3.7%</b>	<b>11.2%</b>	<b>11.0%</b>	<b>6.9%</b>	<b>\$148.0</b>
California Public Employees' Retirement System	2.4%	10.9%	10.7%	6.2%	\$301.1
North Carolina Teacher and State Employee Retirement System	2.3%	9.1%	9.5%	6.2%	\$89.6

<sup>1</sup> Period-to-period performance results are very sensitive and dependent on the beginning and endpoints of measurement. Reporting dates for these plans ranged from March 31, 2015, to August 31, 2015. Annualized returns are net of fees.

<sup>2</sup> FRS Pension performance is as of June 30, 2015.

Source: State Board of Administration and OPPAGA review of comprehensive annual financial reports from the Florida Retirement System Pension Plan and other pension plans.

## Agency Response —————

In accordance with the provisions of s. 11.51(2), *Florida Statutes*, a draft of our report was submitted to the Executive Director of the State Board of Administration for review and response. The Executive Director's written response has been reproduced in Appendix A.

## Appendix A

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STATE BOARD OF ADMINISTRATION  
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November 18, 2016

Mr. R. Philip Twogood  
Coordinator  
Office of Program Policy Analysis & Government Accountability (OPPAGA)  
Claude Pepper Building, Room 312  
111 West Madison Street  
Tallahassee, Florida 32399-1475

Dear Mr. Twogood:

We reviewed the preliminary and tentative OPPAGA's report titled: *Over the Long-term, major SBA Fund Returns Exceeded Market-Based Investment Benchmarks; FRS Pension Fund Multi-Year Performance Similar to Other States*. We have no objection or questions in regard to the information presented in the report.

We welcome OPPAGA's efforts and, as always, we appreciate your diligence and professionalism.

Sincerely,

A handwritten signature in cursive script, appearing to read "Ash Williams".

Ashbel C. Williams  
Executive Director & CIO



# *The Florida Legislature*

## *Office of Program Policy Analysis and Government Accountability*



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